No. 79-1362

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In the Supreme Court of the United States

OCTOBER TERM, 1979

AMERICAN FIDELITY LIFE INSURANCE COMPANY, ET AL., PETITIONERS

v.

ALABAMA FARM BUREAU MUTUAL CASUALTY INSURANCE COMPANY, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether respondent, in this action under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, has raised issues of material fact that preclude a grant of summary judgment in favor of petitioners prior to the completion of discovery.

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This brief is filed in response to the Court's invitation to the Solicitor General to express the views of the United States.

STATEMENT

Respondent brought this derivative action in the United States District Court for the Northern District of Florida on behalf of petitioner American Fidelity Life Insurance Company ("AMFI"), a Florida insurance company. The complaint sought damages from five of AMFI's directors for injury suffered as a result of alleged violations by those directors of Sections 10(b) and 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and 78n(a), and Securities and Exchange Commission Rules 10b-5 and 14a-9 thereunder, 17 C.F.R. 240.10b-5 and 240.14a-9. Even though discovery was still in its preliminary stages (Pet. App. 5a-6a), the district court granted summary judgment against respondent and dismissed its securities law claims with prejudice (Pet. App. 41a).

The court of appeals reversed the district court's grant of summary judgment against respondent on the count of the complaint alleging violations of Section 10(b) and Rule 10b-5.[1] The court concluded that genuine issues of material fact exist with respect to whether the petitioner-directors engaged in a manipulative or deceptive device in connection with AMFI's repurchase of approximately 315,000 shares of its common stock.

The court of appeals determined that the complaint adequately alleged "a scheme artificially to manipulate the market and artificially (that is, beyond the operation of

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[1]The court affirmed the grant of summary judgment against respondent on the count of the complaint alleging violations of Section 14(a) of the Securities Exchange Act of 1934 and SEC Rule 14a-9 (Pet. App. 26a).

normal market factors) to inflate prices" (Pet. App. 14a). That scheme allegedly was intended to discourage other persons from purchasing AMFI stock or attempting to gain control of AMFI in order to perpetuate the petitioner-directors' control of AMFI (Pet. App. 4a-5a, 13a-14a). The court of appeals pointed out that petitioners failed to establish the absence of any genuine issue of material fact as to whether AMFI's stock repurchase program was a manipulative scheme that injured the corporation by artificially inflating the price it paid for its own stock (Pet. App. 2a, 21a-22a).

The court of appeals also determined that respondent raised material issues of fact regarding the adequacy of the disclosure of the stock repurchase program. The court found that there were material issues of fact regarding respondent's claims that the petitioner-directors (i) failed to disclose that the repurchase program would be carried out in a manner that would artificially inflate the price of the stock and (ii) issued a deceptive press release announcing that the repurchase program would be carried out in a manner that would not unduly affect the market (Pet. App. 17a). Since the evidence before the court on petitioners' summary judgment motion did not preclude a determination by the trier of fact that petitioners had manipulated the price of AMFI stock and deceived AMFI, the court remanded the case to the district court for completion of discovery and, if necessary, a trial on the merits (Pet. App. 25a-26a).

In discussing respondent's claim of deception, the court of appeals explained that the fact that some or all of AMFI's directors were aware of the scheme to manipulate the stock did not negate the possibility of deception. AMFI could be deceived, the court observed, if the disinterested directors (the directors who did not stand to benefit personally from the repurchase program) or the

shareholders were misled, since those persons stand in the place of the corporate entity in these circumstances (Pet. App. 17a-18a). The court of appeals also explained that the alleged misrepresentation and nondisclosure could be found to be material because a reasonably prudent shareholder or disinterested director, in deciding whether to take steps to halt the stock repurchase program, would have considered this matter important (Pet. App. 20a). Had they known the truth, the stockholders or disinterested directors could have brought suit in state court to enjoin the repurchase program (Pet. App. 19a).

DISCUSSION

The decision of the court of appeals does not conflict with any decision of this Court. Although there is a conflict among the circuits with respect to one secondary aspect of the decision, that conflict is not of sufficient significance to warrant review by this Court at an interlocutory stage in this proceeding.

1. Petitioners argue (Pet. 11) that, on the "central issue" in this case, the court of appeals has held that an allegation of failure to disclose that a corporate stock repurchase program was motivated by the desire of certain directors to maintain control of the corporation is sufficient to state a claim under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. That determination, petitioners contend, is contrary to the reasoning of *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977), and to decisions of three courts of appeals holding that nondisclosure of directors' motives does not violate the statute and rule.

In our view, however, petitioners' interpretation of the court of appeals' decision is incorrect. While there is language in the court of appeals' opinion that, viewed in isolation, suggests such an interpretation, the opinion

must be read in light of the court's explicit holding that disclosure of motivation is not required. See Pet. App. 11a; see also page 7, *infra*. The court of appeals held that summary judgment in favor of petitioners was premature because there are genuine issues of material fact as to whether the stock repurchase program was a manipulative device that injured the corporation by artificially inflating the price at which it purchased shares of its own stock and as to whether there was adequate disclosure concerning the corporation's stock repurchase program. Neither aspect of the court's decision turns on disclosure of the petitioner-directors' motivation for instituting and carrying out the program. Thus, the legal principles on which the decision of the court of appeals rests do not conflict with either the reasoning of *Santa Fe* or the decisions of the Second, Third and Eighth Circuits cited by petitioners.[2]

a. The court of appeals concluded that the respondent raised genuine issues of material fact as to whether the stock repurchase program was in reality a form of market manipulation used to deter investment in AMFI stock by artificially inflating the market price of those securities.[3] Such activity is manipulation "in th[e] technical sense of

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[2]The court of appeals' decision rests on the well established principle that summary judgment should be granted sparingly in complex cases, particularly when discovery has not been completed, and may not be utilized to resolve genuine issues of material fact. See, *e.g.*, *Poller* v. *Columbia Broadcasting System, Inc.*, 368 U.S. 464, 474 (1962). This Court has reaffirmed that principle in the securities law context. See *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 450 & n.11 (1976).

[3]In so holding the court of appeals relied, not on the petitioner-directors' alleged motive to retain control, but on evidence concerning the manner in which the stock repurchase program was conducted (see Pet. App. 22a-24a). The court's *factual* analysis of the adequacy of the evidence suggesting manipulation that respondent presented does not warrant review by this Court, and we express no view on

artificially affecting market activity in order to mislead investors * * *" (*Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 477), which is prohibited by Section 10(b) and Rule 10b-5(a) and (c).[4] See *United States* v. *Charnay*, 537 F. 2d 341, 350, 351 (9th Cir.), cert. denied, 429 U.S. 1000 (1976) (sales of substantial blocks of a security for the purpose of artificially depressing the market price); *Landy* v. *Federal Deposit Insurance Corporation*, 486 F. 2d 139, 161 (3d Cir. 1973), cert. denied, 416 U.S. 960 (1974).

The court of appeals also held that summary judgment was improper with respect to respondent's claim that the petitioner-directors had deceived AMFI through its disinterested directors and stockholders. Petitioners erroneously argue that the court concluded that "all the material terms of the stock repurchase program and all of the facts relating thereto" had been disclosed, thus leaving disclosure of a "motive" to "main[tain] * * * existing corporate control relationships" as the "only issue" (Pet. 13). The court did not, however, find full disclosure of the facts regarding the repurchase program. To the contrary, it found the existence of genuine issues of material fact regarding (i) whether petitioners failed to disclose that the repurchase program would be conducted in a manner that would artificially inflate the price of AMFI's stock and (ii) whether petitioners falsely stated in a press release that the program would be carried out in a manner that would not unduly affect the market price. As

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that question. If, however, AMFI's purchases were effected in accordance with all the requirements that would be imposed by the Commission's proposed Rule 13e-2, 38 Fed. Reg. 34341 (1973), 35 Fed. Reg. 11411 (1970), as petitioners suggest (Pet. 18 n.12), no adverse inference should be drawn on remand from petitioners' decision not to make "less frequent, but larger, purchases" (Pet. App. 22a n.12).

[4]Section 10(b), 15 U.S.C. 78j(b), prohibits the use in connection with the purchase or sale of securities of "any *manipulative* or deceptive *device* or *contrivance*" in contravention of SEC rules (emphasis supplied).

the Ninth Circuit has correctly noted: "Failure to disclose that market prices are being artificially * * * [affected] operates as a deceit on the market place and is an omission of a material fact." *United States* v. *Charnay*, *supra*, 537 F. 2d at 351. See also *TSC Industries, Inc.* v. *Northway, Inc.*, *supra*, 426 U.S. at 463 & n.24.

b. The legal principles underlying the court's decision that summary judgment in favor of petitioners was improper do not conflict with this Court's reasoning in *Santa Fe Industries, Inc.* v. *Green*, *supra*. In *Santa Fe*, the Court considered a claim that a short-form merger transaction used by the majority stockholder of a corporation to eliminate the minority interest violated Section 10(b) and Rule 10b-5 because there was no valid corporate purpose for the merger and the minority stock was undervalued. The case was presented "on the premise that the complaint failed to allege a material misrepresentation or material failure to disclose." 430 U.S. at 474. This Court concluded that the complaint failed to state a claim for relief because it alleged solely a breach of corporate fiduciary duty, without any element of deception or manipulation.

The court of appeals expressly recognized these governing principles (Pet. App. 7a) but noted that respondent's complaint adequately alleged that petitioners had engaged in a manipulative or deceptive scheme (Pet. App. 13a-14a). The court thus correctly held (Pet. App. 25a) that respondent "is at least entitled to a fair opportunity to develop its case" because petitioners, in seeking summary judgment, failed to establish that their conduct could not "be fairly viewed as 'manipulative or deceptive' within the meaning of the statute." *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 474.

Nor does the decision below conflict with the decisions of the Second, Third, and Eighth Circuits cited by petitioners.[5] The court below specifically rejected respondent's contention that the petitioner-directors' failure to disclose their alleged motive to maintain control violated Rule 10b-5 and noted that cases holding that such disclosure is not required are "sound" (Pet. App. 11a). Agreeing with petitioners on this point, the court stated (*ibid.*):

> Section 10(b) and Rule 10b-5 * * * were not intended to require, under normal circumstances, the disclosure of an individual's motives or subjective beliefs, or his deductions reached from publicly available information.[6]

Thus, this case does not present and we express no view concerning the question whether failure to disclose motivation can constitute a violation of Rule 10b-5.[7]

2. Petitioners also ask this Court to resolve a conflict among the courts of appeals on the question whether, in

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[5] *Rodman* v. *Grant Foundation*, 608 F. 2d 64 (2d Cir. 1979); *Biesenbach* v. *Guenther*, 588 F. 2d 400 (3d Cir. 1978); *Golub* v. *PPD Corp.*, 576 F. 2d 759 (8th Cir. 1978).

[6] The opinion does contain language that, if read in isolation, could lead to the conclusion that the court believed that the subjective motivation of the directors for inflating the market price should be disclosed in addition to the inflationary effect of the purchases and the nature of the scheme (see Pet. App. 17a). However, in view of the court's lengthy discussion of the issue and its express statement that Rule 10b-5 does not require disclosure of motivation, the opinion cannot fairly be read to hold the contrary.

[7] Motivation can, however, constitute evidence pertinent to the question whether petitioners' conduct was manipulative. A motive to manipulate, coupled with a series of stock purchases, can establish a prima facie case of manipulation. See III L. Loss, *Securities Regulation* 1552-1553 (2d ed. 1961); *TSC Industries, Inc.* v. *Northway, Inc.*, *supra*, 426 U.S. at 463 n.24.

certain cases involving deception of a corporation through its disinterested directors or its stockholders. Section 10(b) and Rule 10b-5 require proof that a derivative plaintiff would have been successful in a state court action (Pet. 22-24). While the court below did acknowledge that its position on this question differed from that of the Ninth Circuit and possibly that of the Seventh Circuit (see Pet. App. 19a), we do not believe that the difference requires this Court's review, particularly in the interlocutory procedural posture of this case.

The question raised by petitioners is a subsidiary aspect of the court of appeals' determination that deception of AMFI could be found, even though some or all of the directors authorizing the stock purchase plan were aware of the material facts, if the disinterested directors or the shareholders were misled (see Pet. App. 17a-18a). Petitioners do not challenge this proposition. The courts of appeals that have considered this question have, without exception, agreed that a corporation may be defrauded if persons interested in a corporate securities transaction are in a position to control the decision of the corporation and disclosure of material facts is not made to the disinterested directors or the stockholders.[8] The

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[8]See, *e.g.*, Pet. App. 17a-18a; *Kidwell ex rel. Penfold* v. *Meikle*, 597 F. 2d 1273, 1291-1292 (9th Cir. 1979); *Wright* v. *Heizer Corp.*, 560 F. 2d 236, 249 (7th Cir. 1977), cert. denied, 434 U.S. 1066 (1978); *Goldberg* v. *Meridor*, 567 F. 2d 209, 215-218 (2d Cir. 1977), cert. denied, 434 U.S. 1069 (1978); *Bailey* v. *Meister Brau, Inc.*, 535 F. 2d 982, 993 (7th Cir. 1976); *Shell* v. *Hensley*, 430 F. 2d 819, 827 (5th Cir. 1970); *Rekant* v. *Desser*, 425 F. 2d 872, 879-882 (5th Cir. 1970); *Schoenbaum* v. *Firstbrook*, 405 F. 2d 215, 219-220 (2d Cir. 1968) (en banc), cert. denied, 395 U.S. 906 (1969); *Pappas* v. *Moss*, 393 F. 2d 865, 869 (3d Cir. 1968); *Ruckle* v. *Roto American Corp.*, 339 F. 2d 24, 29 (2d Cir. 1964). See also *Popkin* v. *Bishop*, 464 F. 2d 714, 719-720 (2d Cir. 1972); *O'Neill* v. *Maytag*, 339 F. 2d 764, 768 (2d Cir. 1964). Several of these cases were cited by this Court in *Santa Fe* as

courts of appeals have likewise agreed that, in such cases, a cause of action is stated if shareholders could have taken advantage of available state law remedies to enjoin the transaction if they had been aware of the true facts.[9] Petitioners express no contrary view.

The divergence of views relates only to a secondary question: To establish a claim under Rule 10b-5, must a plaintiff demonstrate that his state court injunctive action would have been successful? Only the Ninth Circuit has held that such a showing must be made. *Kidwell ex rel. Penfold* v. *Meikle*, 597 F. 2d 1273, 1294 (9th Cir. 1979). The Third Circuit, like the court of appeals in this case, has concluded that proof of ultimate success in state court need not be established. *Healey* v. *Catalyst Recovery of Pennsylvania, Inc.*, 616 F. 2d 641, 647 (3d Cir. 1980); Pet.

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examples of cases involving an element of deception. *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 475 n.15.

See also *Maldonado* v. *Flynn*, 597 F. 2d 789, 795 (2d Cir. 1979); *Dasho* v. *Susquehanna Corp.*, 461 F. 2d 11, 25-26 (7th Cir.), cert. denied, 408 U.S. 925 (1972) (knowledge of *disinterested* directors is attributed to the corporation, precluding a finding of deception).

[9]See Pet. App. 19a; *IIT* v. *Cornfeld*, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) para. 97,320 at 97,165 (2d Cir. Mar. 17, 1980); *Kidwell ex rel. Penfold* v. *Meikle*, *supra*, 597 F. 2d at 1291-1292; *Wright* v. *Heizer Corp.*, *supra*, 560 F. 2d at 250; *Goldberg* v. *Meridor*, *supra*, 567 F. 2d at 219-220. See also *Healey* v. *Catalyst Recovery of Pennsylvania, Inc.*, 616 F. 2d 641 (3d Cir. 1980); *SEC* v. *Parklane Hosiery Co.*, 558 F. 2d 1083, 1088 (2d Cir. 1977).

In *Santa Fe*, this Court held that nondisclosure of the terms of a short-form merger prior to completion of the merger was not material where state law afforded only an appraisal remedy and not injunctive relief. Because the plaintiffs "d[id] not indicate how they might have acted differently had they had prior notice of the merger * * *, the failure to give advance notice was not a material nondisclosure within the meaning of the statute or the Rule." *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 474 n.14.

App. 18a-19a.[10] The Seventh Circuit was able to conclude, after a full trial, that the plaintiff would have succeeded in state court and did not reach the question whether proof of success was essential. *Wright* v. *Heizer Corp.*, 560 F. 2d 236, 250-251 (7th Cir. 1977), cert. denied, 434 U.S. 1066 (1978).[11]

In our view, the approach adopted by the court of appeals here—requiring only that the plaintiff "make out a prima facie case for [state court] relief" (Pet. App. 19a)—is both sound and practical. Indeed, in the present procedural posture of this case, it is difficult to see how the court of appeals could have applied any other standard. Respondent has not yet completed discovery and thus has not yet developed evidence sufficient to establish conclusively that a state court action would have been successful. In resisting a motion for summary judgment at this preliminary stage of a lawsuit, a plaintiff who claims injury because a fact omitted or misrepresented in connection with a securities transaction would be important in pursuing an available state law remedy against the transaction need only meet the ordinary standards applicable to a party opposing summary judgment. See *TSC Industries, Inc.* v.

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[10]In *Healey*, *supra*, the plaintiff, a minority shareholder, sued under Section 10(b) and Rule 10b-5 in his individual capacity for damages and an injunction to bar a merger approved by shareholder vote. A majority shareholder repeatedly had failed to provide the plaintiff with information that the court of appeals found would have created a "reasonable probability of ultimate success" in a state court action to enjoin the merger. 616 F. 2d at 647.

[11]In *Goldberg* v. *Meridor*, *supra*, 567 F. 2d at 220-221, the Second Circuit did not address the question whether a state court injunction would have been obtained. See also *ITT* v. *Cornfeld*, *supra*, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) para. 97,320 at 97,165.

Northway, Inc., supra, 426 U.S. at 450; see also *Healey* v. *Catalyst Recovery of Pennsylvania, Inc., supra*, 616 F. 2d at 647-648.[12]

There are additional reasons why review by this Court of the decision of the court of appeals is inappropriate at this time. As previously noted, the court of appeals determined that respondent raised genuine issues of fact not only with respect to its claim of deception, but also with respect to its claim of market manipulation. Thus, there is an independent basis for the decision of the court of appeals remanding the present case for further proceedings. In addition, due to the interlocutory posture of the present case (see *Brotherhood of Locomotive Firemen* v. *Bangor & Aroostook R.R.*, 389 U.S. 327, 328 (1967)), it is impossible to determine whether the legal issue that petitioners seek to litigate in this Court will be dispositive of the present case. On remand, after an opportunity for "full discovery" (Pet. App. 21a), respondent may be unable to demonstrate that the stock repurchase program was carried out in a manner that artificially inflated the market price of AMFI stock. The

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[12]The court of appeals' conclusion that the plaintiff must make a prima facie showing of entitlement to relief in state court avoids the necessity of a full-blown trial of the state law claim in federal court (as would be required under the Ninth Circuit's view) and also avoids the undesirable consequence of permitting a meritless claim to go to the jury. See also *Healey* v. *Catalyst Recovery of Pennsylvania, Inc., supra*, 616 F. 2d at 648, noting that the district court should "determine whether any of that information could have been used to obtain a [state court] injunction. If there was as a matter of law no reasonable probability of ultimate success, the information is not material." Of course, a plaintiff seeking damages under Section 10(b) based on omission or misrepresentation of information in connection with a stock transaction must prove, in addition to materiality (*TSC Industries, Inc.* v. *Northway, Inc., supra*), that the defendants acted with scienter (*Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976)), and that the violation caused an ascertainable injury (*Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 389 (1970)).

question whether the omitted or misrepresented fact—the program's alleged manipulative nature—should have been disclosed would then become moot. Resolution of the state law relief question may thus be irrelevant to the ultimate outcome of this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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